cases, board members are nominated by private associations whose constituencies are not necessarily focused on the protection of the public.

The Committee believes that greater independence of state boards of accountancy would enhance their regulatory effectiveness. The Committee recommends that, working with NASBA, states evaluate and develop means to make their respective state boards of accountancy more operationally and financially independent of outside influences. The Committee notes that this Recommendation to ensure the independence of state boards of accountancy is not meant to limit in any way the efforts of regulators and other governmental enforcement bodies to coordinate their regulatory and enforcement activities as recommended in Recommendation 2(b).

Recommendation 3. Urge the PCAOB and the SEC, in consultation with other federal and state regulators, auditing firms, investors, other financial statement users, and public companies, to analyze, explore, and enable, as appropriate, the possibility and feasibility of firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency at auditing firms.

In response to the recent corporate accounting scandals, related legislative and regulatory requirements and best practices, public companies enhanced their corporate governance. One of the most prominent alterations to the corporate governance scheme was the increased representation and strengthening of independent members of boards of directors. The New York Stock Exchange and the Nasdaq enhanced their public company listing standards to call for a majority of independent board members.[97] Best practices have gone even further, calling for a ''substantial majority'' of independent directors.[98]

A combination of Sarbanes-Oxley provisions and exchange listing standards mandate fully independent audit committees, nominating/corporate governance, and compensation committees.[99] In addition, independent directors' responsibilities have increased. For example, the independent audit committee now appoints, oversees, and compensates the auditor.[100] Although difficult to quantify the benefits of these enhancements, many have extolled these reforms as improving the quality of board oversight, reducing conflicts of interest, and enhancing investor confidence in public company operations and financial reporting.[101]

Public company auditing firms as private partnerships are not subject to these requirements. Instead, state laws and partnership agreements determine the governance of auditing firms.[102] Often a firm's governing body is comprised of elected firm partners.[103] Some firms are currently using advisory boards, although these may not be well-publicized or transparent.

Several witnesses testified to the benefits of improving auditing firm governance and suggested the addition of independent members to the boards of directors.[104] One witness called for an entirely independent board with enhanced responsibilities, including chief executive officer selection, determining partner compensation, and monitoring potential conflicts of interest and audit quality.[105] An auditing firm representative noted that his firm was considering adding independent members on its international governing board.[106]

The Committee believes that enhancing corporate governance of auditing firms through the appointment of independent board members, whose duties run to the auditing firm and its partners/owner, to advisory boards with meaningful governance responsibilities (possible under the current business model), and/or to firm boards could be particularly beneficial to auditing firm management and governance.[107] The Committee also believes that such advisory boards and independent board members could improve investor protection through enhanced audit quality and firm transparency. The Committee is particularly intrigued by the idea of independent board members with duties and responsibilities similar to those of public company non-executive board members.

The Committee recognizes the multiple challenges that instituting a governance structure with independent board members might entail, including compliance with state partnership laws and independence requirements, insurance availability for such directors, and liability concerns. Accordingly, the Committee recommends that the PCAOB and the SEC, in consultation with federal and state regulators, auditing firms, investors, other financial statement users, and public companies, analyze, explore, and enable, as appropriate, the possibility and feasibility, within the current context of independence requirements and the liability regime, of firms' appointing independent board members and advisory boards. The Committee notes that the PCAOB and the SEC should consider the size of auditing firms in analyzing and developing any governance proposals.

Recommendation 4. Urge the SEC to amend Form 8–K disclosure requirements to characterize appropriately and report every

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H. Finance Committee of the Ohio House of Representatives 1 (Mar. 18, 2005) (''The evidence shows that 'consolidated' states have difficulty in effectively enforcing the statutes governing the profession under their central agency umbrella.'').

[97] New York Stock Exchange, Listed Company Manual § 303A.01 (2003); Nasdaq, Manual, Rule 4350(c).

[98] See, e.g., The Business Roundtable, Principles of Corporate Governance (May 2002) (recommending, among other things, a substantial majority of independent directors and fully independent audit, corporate governance/nominating, and compensation committees); The Conference Board, Commission on Public Trust and Private Enterprise (Jan. 9, 2003) (recommending, among other things, a substantial majority of independent directors and regular executive sessions of the independent directors).

[99] Sarbanes-Oxley Act, 15 U.S.C. § 78–j (2002) (mandating audit committees comprised solely of independent directors); New York Stock Exchange, Listed Company Manual § 303A.04 (2004) (requiring nominating/corporate governance committees comprised solely of independent directors); New York Stock Exchange, Listed Company Manual § 303A.05 (2004) (requiring compensation committees comprised solely of independent directors); New York Stock Exchange, Listed Company Manual § 303A.06 (2003) (mandating compliance with SEC rules requiring audit committees comprised solely of independent directors); Nasdaq, Manual, Rule 4350(d) (mandating compliance with SEC rules requiring audit committees comprised solely of independent directors). Note that the Nasdaq listing standards do not require the existence of nominating/corporate governance committees and compensation committees.

[100] Sarbanes-Oxley Act, 15 U.S.C. § 78–j (2002).

[101] For example, see the commentary accompanying New York Stock Exchange, Listed Company Manual § 303A.01 (''Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest.'').

[102] Center For Audit Quality, Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession 2 (Jan. 23, 2008).

[103] Center For Audit Quality, Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession 2–22 (Jan. 23, 2008) (detailing the various governance structures of the largest six auditing firms); Cynthia M. Fornelli, Executive Director, Center for Audit Quality, and James S. Turley, Chair, Governing Board, Center for Audit Quality, and Chairman and CEO, Ernst & Young LLP, Comment Letter Regarding Discussion Outline 13 (Nov. 30, 2007), *available at http://comments.treas.gov/_files/Treasurycomment letterfinal11302007.pdf* (noting the largest auditing firms have supervisory boards overseeing management).

[104] See, e.g., Andrew D. Bailey, Jr., Professor of Accountancy-Emeritus, University of Illinois, and Senior Policy Advisory, Grant Thornton LLP, Comment Letter Regarding Discussion Outline 12 (Jan. 30, 2008), *available at http://comments.treas.gov/_files/BAILEYCOMMENTSONTREASURY ADVISORYCOMMITTEEOUTLIN EFINALSUBMISSION13008* (''[I]ndependent board members similar to those found on public company boards would be a good governance practice and would signal the markets about the firms' positive commitment to the public good.''); Record of Proceedings (Feb. 4, 2008) (Written Submission of Dennis Johnson, Senior Portfolio Manager, Corporate Governance, California Public Employees' Retirement System, 3), *available at http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Johnson020408.pdf* (stating that independent board of directors could possibly decrease potential conflicts of interest).

[105] Record of Proceedings (Feb. 4, 2008) (Written Submission of Paul G. Haaga Jr., Vice Chairman, Capital Research and Management Company, 2), *available at http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Haaga020408.pdf*.

[106] Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 7), *available at http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf*.

[107] Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 7), *available at http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf* (''Such a change in the governance model may be one way to strengthen our ability to serve market participants and reinforce independence.'').